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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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OFFICE OF SPECIAL PROGRAMS
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• REGULATORY REPORTS REVIEW



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JUL 15 1975

The Honorable Frank Zarb
Administrator
Federal Energy Administration

Dear Mr. Zarb:

Pursuant to your request we surveyed the efforts of the Federal Energy Administration (FEA) to audit fuel oil suppliers of major utility companies (Project Utility). Our review was made at FEA headquarters and at its regional offices in Atlanta, Boston, Dallas, Kansas City, Philadelphia, and San Francisco. We discussed the program with headquarters officials, regional compliance and enforcement directors, and field auditors and reviewed available program documents.

On June 13, 1975, we briefed you and your staff members on the results of our review. This letter summarizes the matters discussed in that briefing.

Specifically we found that:

- The effective manpower assigned to the project has been far less than the level reported to FEA headquarters.
- Inconsistent auditing among FEA regions has resulted in substantial audit effort in areas unlikely to yield evidence of violations.
- Investigations have been delayed because of complex supplier relationships, inadequate supplier records, and poor coordination among FEA regional offices.
- Regulatory questions have impeded completion of a number of investigations.

While there has been considerable publicity regarding Project Utility, we found that the amount of violations detected has not justified the emphasis placed on the project. Also, the violations detected have not been unique to the utility area but apply to other fuel suppliers' customers as well.

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BACKGROUND

FEA's compliance and enforcement program is aimed at assuring industry compliance with petroleum price regulations established under the Emergency Petroleum Allocation Act of 1973 (87 Stat. 627) and the Federal Energy Administration Act of 1974 (88 Stat. 96). Under FEA's regulations, wholesalers may charge their May 15, 1973, prices, increased dollar for dollar for any additional product costs incurred after that date. Further, when the firms can substantiate increases in nonproduct costs, such as labor or overhead, they are allowed additional price increases.

Historically, FEA's compliance and enforcement program has been directed toward four basic levels of the petroleum industry--producers, refiners, wholesalers, and retailers. As of May 29, 1975, FEA had 727 employees assigned to the program.

FEA's Dallas and Atlanta regional office investigations of wholesalers in mid-1974 indicated that some utilities were being charged excessively high prices for fuel oil. In November 1974 FEA personnel from the Dallas and Atlanta regions and the national office met to discuss the results of the initial efforts. Following the meeting, headquarters compliance and enforcement personnel recommended to the FEA Administrator that a special effort be started to detect overcharges to utilities. The Administrator agreed and on December 11, 1974, FEA issued a press release which stated, in part, the following:

"Federal Energy Administrator John C. Sawhill today announced the immediate kick-off of 'Project Escalator.' A special Federal task force of 30 investigators is being assembled from FEA's current field enforcement staff. They will investigate potentially widespread price-gouging involving sales of fuel oil to public utilities. If violations are widespread as early information indicates, the investigation could result in tens of millions of dollars in overcharges being returned to the consumer.

* * * * *

"* * * Our ultimate aim is to get the dollars returned to the consumer in the form of price reductions on future purchases."

C1 Also on December 11, 1974, in testimony before the Subcommittee on Reorganization, Research, and International Organizations, Senate Government Operations Committee, an FEA official stated that the project could result in as much as \$100 million in overcharges being returned to consumers. Such statements and the widely publicized Jacksonville-Yen Fuel case created great interest in the project. 01508

The program was subsequently renamed Project Utility.

On January 8, 1975, the national office provided regional compliance and enforcement staffs a program guide for use in conducting investigations. The guide stated that each region should select at least two utility companies on the basis of such criteria as market size, amount of fuel oil used, and complaints concerning large increases in customers' bills. At the utilities selected, FEA field investigators were to determine fuel oil prices paid by utilities and fuel oil suppliers' names and locations.

Many fuel-burning utilities obtain supply from a number of fuel wholesalers who in turn obtain fuel from another set of wholesalers. Each set of wholesalers is referred to as a "tier," and there may be three or four wholesaler tiers for each utility. The system by which wholesalers operate between a refiner and a fuel user is generally called a "supply chain." Prices charged by a wholesaler are influenced by prices paid to other wholesalers located in the chain's lower tiers. Complications occur when wholesalers in the chain sell the fuel back and forth among themselves or when a wholesaler operates in more than one tier of the chain.

INVESTIGATION PROBLEMS

Manpower

While FEA regions reported--and FEA publicized--that about 110 auditors were assigned to Project Utility, we found that the manpower effectively assigned to the project was far less than the reported level. On the basis of the number of manhours reported by the regions, we computed that, on the average, 39 auditors were effectively assigned to Project Utility from January through mid-May 1975. For the week of May 16, 1975, about 22 auditors were effectively assigned to the project. Reasons for this low manpower level were that (1) some auditors were assigned only part time, (2) regional reporting was inaccurate due to various staffing changes, and (3) auditors returned to other compliance activities while awaiting assistance from other FEA regional auditors.

We also noted workload variations among the regions. For example, during the week of May 16, 1975, the San Francisco region had 1 auditor for every 3 supplier investigations while the Atlanta region had 1 auditor for every 11 supplier investigations.

Assigning auditors to Project Utility has also drained staff from other compliance and enforcement programs. Auditors have been reassigned from producer audits and some auditors of major refiners spend time assisting in investigations when a refinery is involved. In addition, some personnel hired recently to increase manpower at the refinery level have been assigned to Project Utility.

Utilities typically burn Number 2, 4, 5, and 6 fuel oil and, in some cases, jet fuel.

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Inconsistent audit practices in FEA regions

Criteria for selecting suppliers for investigation were not incorporated into the January 8, 1975, program guide, and any verbal criteria provided by the national office were not uniformly adopted. This resulted in inconsistent practices among regions and in substantial audit effort in areas unlikely to yield evidence of violations.

Some regions were attempting to investigate all suppliers while other regions were selecting suppliers on the basis of such criteria as the amount of fuel supplied to the utility or the prices charged. In some investigations all of a suppliers' fuel sales to all types of customers were audited, while in others only sales to utilities were audited. When auditors detected violations, some regions immediately expanded the investigation to cover all of the suppliers' fuel , while other regions noted the questionable transactions for followup at some unspecified later date.

Such practices have led both FEA national and regional office officials to estimate that over 50 percent of the time spent on Project Utility has involved audits of reasonable priced fuel purchases

Investigation delays

The complexity of supply chains has been a major problem for FEA auditors. To illustrate the complexity, FEA identified 13 wholesalers providing fuel oil directly to 1 utility. For 1 of those 13 direct suppliers, FEA identified 29 lower tier suppliers. This is a common occurrence. Auditing throughout this complex supply chain is extremely time consuming. A simplified supply chain is diagramed in the enclosure.

Brokers who charge a commission for finding fuel oil buyers and sellers may also operate anywhere within these supply chains. Brokers rarely take physical possession of the fuel but merely arrange transactions. In many cases, supplier records, particularly those of brokers, have been inadequate. For example, the only record kept by a Philadelphia broker was in his check-book.

In other cases, a utility may be located in one FEA region while the utility's supplier is located in another region. In that event, the FEA region where the utility is located requests the other region's assistance. The January 8, 1975, program guide provides that another region's investigation requests should be completed within 15 days and returned to the requester

We found that assistance requests among FEA regions were not being handled promptly. In the 6 regions visited, 90 assistance requests had been made but only 20 had been filled. Many of the unfilled requests had been made as early as January 1975, and FEA auditors did little followup to determine the status of their assistance requests. Since investigations could not be continued or completed until the assistance requests were

completed, many audits were suspended. When cases are suspended, auditors return to other projects or investigations.

Regulatory questions

Auditors assigned to Project Utility have encountered some regulatory questions which will have to be resolved before certain cases can be completed.

FEA auditors are not certain that brokers are properly covered by the regulations because their operations are not typical of wholesale operators. Many brokers began operations around the oil embargo period and did not have a May 15, 1973, base price similar to that of other wholesalers.

For these brokers and other wholesalers who began operations after May 1973, some FEA auditors have applied the "nearest comparable outlet" rule to determine the proper base period prices. This rule specifies that the base period price for such wholesalers is the same as that charged by the nearest comparable outlet on the day of the wholesaler's first sale. Regional officials and auditors said it was extremely difficult to find the nearest comparable outlet and that there may not even be such comparable outlets in the case of some brokers. Until the base period prices are established, the auditors have no basis on which to judge the reasonableness of the prices charged.

In addition a number of brokers and wholesalers operated outside the traditional supply chains and were not included in FEA's mandatory allocation program. FEA auditors are uncertain whether these brokers' margins or wholesalers' prices can be questioned if they failed to comply with the allocation regulations.

According to an FEA Office of General Counsel official, brokers are not considered wholesalers or resellers and are not subject to the nearest comparable outlet rule or FEA allocation regulations. The official stated further that a broker is considered an agent of the company which pays his commission and that the commission is considered a nonproduct labor cost. The official stated that the Office of General Counsel intends to prepare a memorandum for FEA auditors explaining the brokers' legal status under FEA regulations.

PROJECT RESULTS

As of May 16, 1975--the date of the latest FEA statistics available at the time of our review--FEA had targeted for investigation 336 suppliers of 48 utilities. Of the 80 investigations that had been completed, only 9 violations totaling about \$1.7 million had been detected. Despite the project's focus on utilities, about \$600,000, or over 30 percent of the violations, involved fuel users other than utilities, such as railroads or

municipalities. Both national and regional officials told us that other bulk customers of fuel oil suppliers are just as likely to be overcharged as utilities. FEA officials estimated that potential violations based on cases in process at the six regions we visited totaled about \$5.2 million. While estimates of a few potential violations in the four regions not visited are large, we do not believe the results of the project to date have met initial expectations.

While the project's stated objective was to return dollars to the consumer, regional officials were concerned that refunds might not reach consumers because FEA has had no authority to require the utilities to pass these refunds on to their consumers. These regional officials suggested that they be given authority to notify the public utility commissions or state regulatory agencies when refunds are made to insure that these refunds are passed on to consumers.

CONCLUSIONS

We conclude that:

- Premature publicity has created pressure to complete Project Utility.
- Other fuel users are just as likely to be overcharged by fuel suppliers as are utilities.
- Since FEA has no authority over public utilities there is no assurance that refunds made to them will be returned to consumers.
- Poor communication and coordination were evidenced by the varying practices among the regions.
- Project Utility has hindered other compliance activities, such as the producer and refiner audits.

We believe that utilities, as well as other major fuel oil purchasers, can be used to identify suppliers charging questionable prices for their products. Once such suppliers have been identified, we believe that their transactions with other customers should also be investigated.

RECOMMENDATIONS

We recommend that FEA:

- Phase out Project Utility as a special effort. Complete promising investigations and initiate compliance actions within a specified time frame. Any remaining cases should be folded into the wholesale investigations program.

--Return to balanced compliance operations covering producers, refiners, wholesalers, and retailers.

--Refine wholesale investigations by implementing more consistent criteria for selecting suppliers and for identifying suspicious transactions. Priorities within the wholesale area should be established; utilities and other major fuel users should be used to identify suppliers for audit.

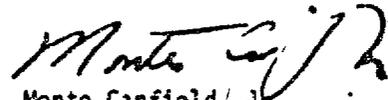
--Promptly inform field auditors of the brokers' proper status under FEA regulations.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions he has taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Because of their expressed interest, we are also furnishing copies of this letter to the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce; Subcommittee on Conservation, Energy, and Natural Resources, House Committee on Government Operations; and the Subcommittee on Administrative Practice and Procedure, Senate Committee on the Judiciary.

We wish to compliment your staff, both at headquarters and at the regional offices we visited, for their fine cooperation during this review.

Sincerely yours,


Monte Canfield, Jr.
Director

Enclosure

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